

Vietnam: Laying the Foundation for Steady Growth

Vietnam is one of the fastest growing economies in the world. It is going through a far-reaching transformation from an inward-looking planned economy to one that is globalized and market-based. It has the potential to be one of the great success stories in development.

Country Indicators	1993	2005	2007
GNI per capita (Atlas Method, US\$)	170	620	815
Inflation (CPI, annual rate, %)	8.4	8.4	12.7
External debt (% of GNI)	191	33	30
Poverty incidence (% of population with consumption below basic needs level)	58	20 (2004)	16 (2006)
Net primary school enrollment rate (%)	77 (1990)	94 (2004)	97 (2006)
Under-five child mortality rate (per 1,000 live births)	53 (1990)	27	26 (2006)
Maternal mortality rate (per 1,000,000 live births)	200	80	75.1 (2006)
Population (millions)	70.3	83.1	85.2
Population growth rate (% per year)	2.0	1.3	1.2

Source: Vietnam, General Statistics Office; World Bank, Development Data Group.

Real income has grown 7.3 percent per year over the last 10 years. When the World Bank reengaged with Vietnam in 1993, income per capita was US\$170. In 2008, it could cross the US\$1,000 mark. The poverty rate has fallen from 58 percent in 1993 to 16 percent in 2006. Vietnam can reach most of the Millennium Development Goals.

Vietnam is a major recipient of IDA resources, although it is not an aid-dependent country. The World Bank is the coordinator of foreign aid to Vietnam because of the large volume of resources it mobilizes and especially because of the Bank's recognized technical expertise. This has led to a very effective dialogue on the policy reforms that underpin Vietnam's transition to a market-based economy.

COUNTRY ACHIEVEMENTS

Vietnam's development achievements have been remarkable.

By the mid-1980s, this war-ravaged country faced famine and a failing command economy. The government launched a renovation process (*Doi Moi*) in 1986, even as it saw the collapse of the Soviet Union—its main trade partner and a vital source of foreign assistance—and had to deal with a domestic fiscal crisis and hyperinflation. *Doi Moi* experimented with market mechanisms while trying to preserve social inclusion.

An egalitarian redistribution of farmland, coupled with freer trade in agricultural products and better agricultural support services at the local level, led to a boom in farm exports and a dramatic reduction in rural poverty.

Foreign investment grew as the domestic entrepreneurial spirit was unleashed. Urban residents moved into paid employment, helping to reduce the number of rural poor even more.

Vietnam's economy expanded rapidly. It avoided the economic collapse that other transition economies went through in the early 1990s as well as the economic crisis that several East Asian countries suffered in the late 1990s. The economic growth rate exceeded 8 percent for the last three years and the country is now aiming for middle-income status by 2010.

An institutional overhaul accompanied rapid economic growth

Vietnam's development strategy involves comprehensive reforms across all policy areas, so as to ensure business development, preserve

social inclusion, manage natural resources and strengthen governance. Reforms have not progressed at the same pace across all areas though.

Much has been accomplished in relation to public financial management. Increased decentralization, improved transparency, a growing role of the National Assembly in deciding appropriations and strengthened auditing mechanisms are all part of this process.

The introduction of common regulations and models of corporate governance for all enterprises, regardless of their ownership, has contributed to a level playing field. Private participation has been allowed in most sectors and in state-owned enterprises. State ownership in enterprises is now being transferred out of ministries and provinces, so that those in charge of issuing or enforcing regulations do not face a conflict of interest.

Progress has been most decisive in relation to global integration. Accession to the World Trade Organization (WTO) in January 2007 will result in lower barriers to trade. Most importantly, it opens service sectors to competition and is resulting in a thorough revamping of the legal system.

Important measures have also been taken to fight corruption. Vietnam is a country where bribes and unofficial payments put a burden on households, even if they tend to be modest by enterprise standards. An effort is underway to simplify administrative procedures and reduce red tape. Government systems are being strengthened in the most vulnerable agencies, including customs, tax administration and land administration. A mechanism to monitor the assets of senior civil servants has been implemented.

On the other hand, progress has been slower in financial sector reform. While the stock market and the insurance sector have developed considerably, Vietnam still needs to establish a modern central bank. Ownership of financial institutions by commercial interests also needs to be more tightly regulated.

The private sector has emerged as the driver of growth

The transition to a competitive market economy is well under way, driving Vietnam's growth and increasing its resilience.

Private enterprises, whose activities were negligible in 1993, now account for over half of the investments made each year. Faced with increased domestic and international competition and a harder budget constraint, state-owned enterprises have done reasonably well.

The equitization process cut the number of state-owned enterprises by more than half, from 3786 to 1720 over the past nine years, although not across all sectors. This has created increased space for the expansion of private firms. Large state-owned enterprises and state-owned commercial banks are now lined up for equitization, whereas remaining ownership rights by the state are being transferred out of ministries and provinces to avoid a conflict of interest between ownership and regulation.

As the private sector expands rapidly, both domestic and foreign-invested firms have connected solidly with global markets. Private firms now contribute 65 percent of manufactured products and over 70 percent of non-oil exports. Vietnam is more and more an integral part of international production and distribution chains.

IDA CONTRIBUTIONS

The International Development Association (IDA), the World Bank's fund for low-income countries, has helped Vietnam fight poverty through finance for agriculture, infrastructure, health programs, and schools, among other things. The country has received more than US\$6 billion in interest-free credits and grants from IDA, the second largest provider of aid to Vietnam after Japan.

Still, Vietnam is not aid-dependent. Foreign assistance disbursements represent only about 15 percent of total public spending. This forces donors to lift their games and focus their efforts on policy dialogue, research, and investments in key development areas.

Since 1993, the Bank's partnership with Vietnam has contributed to achieving notable results.

Supporting policy reforms

Policy dialogue arguably has had the biggest impact of all donor contributions as it underpins the reforms which are transforming the entire economic system.

Some work has directly affected the government's programs and policies. For example, World Bank research for the national targeted program for poverty reduction resulted in communities participating more in the planning and implementation stages of community-based infrastructure such as clinics and local roads.

Seven poverty reduction support credits (PRSCs) have now been completed with the active participation of 19 donors¹ and co-

1. The 19 donors are: Asian Development Bank, Australia, Belgium, Canada, Denmark, the European Commission, Finland, France, Germany, Ireland, Japan, Luxembourg, the Nether-

financing by 11 of them. These credits have supported reforms across 17 policy areas, including trade integration; financial and state owned enterprise reform; infrastructure; social sector issues (health, education, social protection); natural resource management; and governance. Specific actions in each area were sequenced carefully to match implementation capacity and exploit synergies across sectors.

Some of the benefits of reforms supported by IDA credits include:

- The decision to bring strategic investors into all state-owned commercial banks.
- School quality standards that have improved the quality of teaching
- Land user certificates that list the names of both husbands and wives, thereby allowing women to use the certificates as collateral for bank credits
- A state budget plan disclosed to the public for the first time in 2005
- A State Audit reporting directly to the National Assembly and effectively auditing a growing number of state-funded entities
- A Unified Enterprise Law introducing the same set of corporate governance models for all enterprises, regardless of ownership.

Building local capacity

According to the World Bank's latest client survey, knowledge and technical expertise are among IDA's greatest contributions. The approach has been to build government capacity to undertake its own research for its own purposes.

For example, while the Bank conducted Vietnam's first poverty assessment, the second

lands, Norway, Spain, Sweden, Switzerland, the United Kingdom, and UNDP.

was undertaken jointly with the government. Now the government is doing its own, with the Bank's advice.

In education, the Bank has helped build capacity in setting minimum standards for primary education (for example in teacher qualification), the quality of textbooks, and primary teacher competency profiles. These standards link to national budget allocations. Through a series of IDA education projects, the government is scaling up these innovations geographically and through higher levels of the education system.

Several investment credits aim to revamp business processes in ways that improve efficiency in the use of public resources and increase transparency. They target the agencies more vulnerable to corruption, including customs, tax and land administration.

Coordinating and triggering other donors' support

Vietnam receives close to US\$5 billion a year from more than 30 bilateral and multilateral donor institutions. The World Bank serves as the coordinator and, often, a catalyst for foreign aid to Vietnam not only because of the funds it mobilizes but also because of its recognized technical expertise.

It co-chairs consultative group meetings with the government, leads the policy dialogue, especially in relation to PRSC operations, and increasingly fosters multi-donor credits and initiatives. This includes the public financial management modernization, education for all, and forestry partnerships—all good examples of multi-donor support for government

[[Box: a quote from Klaus Rohland may seem a bit outdated by now. There could be merit in removing this box, or replacing it by something else.]]

Setting Up Systems for Lasting Change

“Our work with the government of Vietnam has focused on systemic issues of education,” says Klaus Rohland, the World Bank’s Country Director for Vietnam.

“At first we built schools—and we still build schools because Vietnam needs more schools than it has. But we have also focused on issues such as teacher training. We’ve worked with the ministry of education and seen a change of attitude. Rather than being a simple provider of education, the ministry now drafts policy for education and focuses on quality—an area where we can bring our international experience to the table.

It’s the same in the health sector or when it comes to roads. We’re not merely building roads but setting up systems for road maintenance. These systemic issues are at the forefront of our work in Vietnam now—and for the next 5 or so years as Vietnam completes its transition to a market economy.”

programs.² Vietnam is now seen as a model for aid harmonization.

Providing good-practice models

Investment credits and technical assistance—for example on river basin management or infrastructure—have provided demonstration effects, influencing government approaches at the technical and policy levels.

IDA expertise on phasing, sequencing, and working across sectors has strengthened the effectiveness of development aid. For

2. The donors involved in public financial management are: Australia, Canada, Denmark, the European Commission, Netherlands and the UK. Education initiatives involve Australia, Belgium, Canada, the European Commission, New Zealand, Norway, Spain and the United Kingdom. Forestry is supported by the Netherlands, Finland, the European Commission and GEF.

example, in the context of the broader infrastructure development undertaken at the national and provincial level, the government has embraced projects that are driven by local communities rather than managed from Hanoi. Energy projects have opened the door to private participation in infrastructure. A credit to support schools in poor areas has led to nationwide standards on school quality and the regular auditing of schools against those standards.

IDA’s impact is felt across sectors.

Transport: There have been remarkable improvements in rural access over the last few years. In 1998, little more than half the rural ethnic minority population of Vietnam lived close to an all-weather road, the remainder experiencing considerable isolation during wet seasons. By 2006, 91 percent of the majority Kinh population and 80 percent of the ethnic minority population resident in rural areas were living within two kilometers of an all-weather road. IDA has financed the rehabilitation of 1,000 kilometers of Highway One—the country’s main transportation artery—with another 900 kilometers under way. It has also provided funds to improve 600 kilometers of another 18 national highways and to perform preventive maintenance of 1,100 kilometers of the national highway network. IDA has also helped build more than 7,000 kilometers of district-level roads. As a result, **6 to 8 million people have better access** to the transport system, speeding up their ability to reach markets, schools and health centers. In addition, IDA has financed the rehabilitation or dredging of 1,100 kilometers of inland waterways in the Mekong Delta and 540 kilometers in the Red River Delta.

Electricity: As a result of the government's rural electrification program, more than 90 percent of rural households now have electricity compared to just over 50 percent 10 years ago. IDA helped design this overall effort and implement it through several projects. One brought electricity to around **2.7 million people** in poor rural areas. Already, this has transformed hundreds of rural communities, enabling small businesses to grow and improving the services of schools and health facilities. Further projects are improving access to electricity for millions more.

Education: School attendance has dramatically improved, with net primary enrollment increasing from 86 percent in 1993 to 96 percent in 2006. For the poorest fifth of the population, the increase was from 71 to 93 percent. For the vulnerable ethnic minority communities, the gain was from 62 to 90 percent. IDA has put more than **80 million** language and mathematics **textbooks** into primary schools across Vietnam, built around 14,000 classrooms, and strengthened teacher training.

Health: IDA is contributing to improvements in the quality of health care services for more than **20 million** people through three regional health support projects. An IDA grant has assisted with the implementation of the National Strategy on HIV/AIDS Prevention in 20 provinces, using a decentralized approach. IDA also finances three regional blood transfusion centers to ensure safe blood supply to the country. IDA's contributions have included support for the national programs for malaria, tuberculosis and acute respiratory infections; essential drugs for healthcare centers; construction and upgrade of 15 health and family planning centers, 137 obstetric and operating rooms in district hospitals, and 2,500 com-

munal health centers; and training for about **22,000 health workers** in more than 2,800 communities in the 18 poorest provinces. Under-five child mortality has dropped from 53 per 1,000 in 1990 to 26 in 2006, while maternal mortality rate has fallen from 200 per 100,000 in 1990 to 75.1 in 2006.

Agriculture and rural growth: By 2007, about half a million households have benefited from IDA supported rural finance projects. Nearly 850,000 loans have been provided throughout rural Vietnam for expanding farm production and off-farm employment, contributing to the creation of more than **200,000 rural jobs**. 37 percent of the borrowers are women. IDA's efforts in agricultural diversification have helped establish 31,900 hectares of rubber smallholdings and rehabilitate an additional 9,400 hectares. IDA resources have also contributed to increased cropping intensity and better flood control through improvements in 41 irrigation and drainage schemes in the Mekong Delta region, benefitting **2.3 million people**.

Urban poor: Through IDA assistance, **2.7 million people** in three cities, including Hanoi, have benefitted from improved or new water supply services. Projects are also under way to improve livelihoods of close to **three million urban citizens**, many of them poor, by providing access to basic infrastructure services, improved flood control, collecting and treating wastewater and solid waste and providing access to micro credit loans for housing improvements, water and sanitation connections and income generation. In addition, there are on-going projects and technical assistance to increase access to financing for urban infrastructure and in strategic planning at the city and provincial level.

A Virtuous Circle

Infrastructure services are proving to be affordable and sustainable. The expansion of services was coordinated with budgetary and financial reforms. Rapid growth and economic diversification, in turn, have increased demand for services while allowing service providers to increase the scale of their operations and lower their costs.

CHALLENGES AHEAD

The next three years will be critical. By the end of this period, the transition to a market economy is likely to be complete and Vietnam will have laid the institutional foundations of a middle-income country.

Whether those foundations will be strong enough to keep growth sustainable and inclusive will depend on policy decisions made during the next few years. This makes it all the more important for donors to sustain a high level of assistance in support of the country's move to middle-income country status.

As Vietnam's economy becomes more sophisticated, new challenges emerge.

For example, mobilizing resources for infrastructure requires stronger frameworks for private participation, including the organization of a market for electricity. In health, the challenge will be to combine efficiency with adequate access for the poor. Rapid growth is putting a heavier burden on natural resources and environmental sustainability, so there is an urgent need for integrated land-use planning, river-basin management and effective pollution control instruments.

A more sophisticated economy requires better feedback mechanisms from the people on

the quality of public policies, and that means increased transparency and accountability. Reforms of banking and state-owned enterprises will need to focus on competition and set best practice standards of transparency and good governance; this has become more pressing with Vietnam's accession to the WTO. Massive urbanization and land conversion and a still weak legal system will amplify opportunities for corruption.

Continued economic growth will depend very much on the government's ability to tackle these issues over the coming years.

These priorities call for stronger IDA support

Supporting good policy choices, especially for governance, and strengthening government systems are important priorities in the short to medium term. But the cost of implementing these will be high.

Recapitalizing state-owned commercial banks and divesting and reforming large state-owned enterprises will lead to redundancies and require an effective social safety net.

Funding infrastructure development is another costly priority. Investment in transport, energy, water, and sanitation needs to be expanded rapidly if the country is to avoid development bottlenecks and attain the key Millennium Development Goals.

Tax revenue alone will not be enough and massive borrowing in international markets could raise the public debt burden beyond prudent levels. Aid on concessionary terms has an important role to play until Vietnam's infrastructure catches up with that of its neighbors and competitors.

Thinking Ahead

Today, more than 90 percent of Vietnam's rural households have electricity. Vietnam's first rural energy project, partially financed by IDA, has spread the benefits of electricity to around 2.7 million people in the poorest areas of Vietnam. People are able to earn more money, study longer, and receive improved healthcare.

A little girl described how she used to spend four hours a day grinding rice for her family and maize for the pigs. With an electricity-powered machine, she says she can "do the work in one hour."

IDA is helping the Government plan the next phase of its rural electrification program. Three IDA-supported projects, stretching to 2010, will help improve distribution and spread coverage to the most remote and isolated households.

Keeping growth inclusive

Resources are still needed to keep growth inclusive. For most of the period after Doi Moi, reducing poverty was mainly an economic issue. Now, poverty efforts are increasingly focused on ethnic minority groups.

Sustained transfers of funds are needed to ensure that the living standards of these groups do not fall further behind those of the majority. IDA resources could be used, for example, to enhance the government's targeted poverty reduction program and national urban (slum) upgrading plan. Vietnam is also trying to build universal programs for health and social insurance. Protecting the gains achieved in health and laying out the foundations of a strong social insurance system will need considerable financial resources over the next 5 to 10 years.

Learning from experience

IDA programs and projects in Vietnam are widely recognized as achieving their development objectives and the quality of project outcomes as rated by independent World Bank assessments remains unsurpassed.

At the same time, however, the IDA program is becoming more complex and "riskier" as it now seeks to promote a set of ambitious second-generation reforms required to establish the institutions of a modern market economy. In addition, the World Bank is increasing its emphasis on fighting corruption and enhancing good governance.

Despite the good ratings, the slow pace of implementation continues to be a challenge for IDA and for other donors, as government systems and processes have been stressed by a rapidly growing portfolio.

The Government is committed to accelerate the implementation of ODA programs and projects and has engaged key donors in a systematic and coordinated manner in its efforts to identify bottlenecks and find harmonized solutions.

Improving the mix of financing instruments and products, enhancing operational efficiency, further harmonizing donor procedures and strengthening country systems will be vital to further enhancing the effectiveness of IDA programs.

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